STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105

FINAL STATEMENT OF REASONS

January 22, 2008 **REG-2007-00045**

SALES TO MILITARY PERSONNEL

UPDATED INFORMATIVE DIGEST

There is no need to update any of the information contained in the Informative Digest for this matter.

UPDATE OF INFORMATION CONTAINED IN INITIAL STATEMENT OF REASONS

On December 21, 2007 the Department issued a Notice of Amendment to Text of Regulation. A public comment received in response to the originally noticed text of regulations had indicated the presence of a potential clarity problem in the definition of the term "side fund" in Section 2695.24 of the proposed regulations. Accordingly the Department amended the regulations to eliminate the possibility that the definition might be misunderstood in the way it apparently had been. Additionally, the Department took the opportunity to remedy two other potential clarity problems present in the originally noticed Text of Regulations. Each of these arguably substantive changes were made to subdivision (n) of Section 2695.24.

The definition of "side fund" in the model regulation and in the originally noticed regulations contained three exceptions. The first exception was for certain values or guarantees provided by universal life policies. The second exception was for certain cash values provided by whole life policies. According to the model regulation and the regulations originally proposed by the Department, none of these values or guarantees constituted a "side fund" as defined. However, in its review of public comments the Department became aware of the fact that the exception for cash values provided by a whole life policy had been read as including not only cash values themselves but also funds or reserves which could be characterized as being part of a cash value. This potential ambiguity — whether the exception applied only to cash values themselves or also to other policy features that could be viewed as components of cash values — needed to be resolved in order for the regulations to meet the clarity standard of the Administrative Procedure Act.

A cash value in a life insurance policy is a theoretical amount that can be calculated at any given point, according to a formula specified in the policy, which amount the policy holder can under certain conditions receive when she surrenders the policy to the insurer. The definition of "side fund" in the model regulation and in the originally noticed regulations specified that the cash values provided by a whole life policy that were excepted were cash values subject to the

Standard Nonforfeiture Law for Life Insurance (Article 3A of Chapter 1 of Part 2 of Division 2, commencing at section 10159.1, of the Insurance Code). It is this Standard Nonforfeiture Law that requires insurers to include language in life policies providing for a cash value and spelling out the method by which cash values will be calculated. The law also sets out minimum requirements applicable to cash values, although insurers are free to provide for cash values that are more generous than the required minimums. Each unrestricted reference to "cash value" in the Standard Nonforfeiture Law for Life Insurance is more precisely a reference to "cash surrender value." See, e.g., Ins. Code § 10160. Accordingly, the reference in the model regulation and in the regulations originally noticed by the Department to "cash values provided by a whole life policy which are subject to" the Standard Nonforfeiture Law for Life insurance is clearly a reference to cash surrender values, since cash surrender values and no other kind of cash values are the subject of that law.

As applied to life insurance policies, the term "cash value" is synonymous with the term "cash surrender value." In fact, virtually every mention of the term "cash value" as it applies to a life policy (as opposed to the cash value of property, for instance, or of services rendered) throughout the Insurance Code and regulations promulgated thereunder is, more precisely, a reference to cash surrender value. It is possible, however, that language in an insurance policy could define the term "cash value" as something other than the amount to which an insured is entitled when he surrenders his life policy. An insurer might, for instance, define both the term "cash value" and the term "cash surrender value" in the same policy, assigning to "cash value" the meaning commonly ascribed to "account value" and distinguishing "cash surrender value" as the lesser amount the insured would actually receive, after surrender charges had been extracted. This is an instance of a kind of confusing terminology that could very well result in disapproval of a policy form by the Department, if the Department had approval authority over the kind of policy in question. (There a many life products over which the Department does not have policy approval authority, for instance nonvariable whole life policies.) The common meaning of "cash value" as the term is understood by lay people is consistent with the meaning the term is given in the Nonforfeiture Law and consistent with the usage of the term in the Insurance Code generally: "Cash value" means the amount of cash one can actually receive for the policy, for "cash" itself is widely understood to mean money that can be spent immediately, without restriction.

So that there can be no doubt as to exactly what it is that is excepted, however, we have changed each instance of "cash value" in the definition of side fund to "cash surrender value." The change does not change the meaning of the model regulation but eliminates the potential that the term "cash value" might be interpreted to mean something other than what it means in the Insurance Code and in general usage. For instance, a definition of the term "cash value" in policy forms that diverges from this intended meaning will have no effect on the scope of the exception.

Similarly, in order to eliminate the potential ambiguity as to whether the exception from the definition of "side fund" for cash (surrender) values provided by a whole life policy applies only to those values themselves or also to other policy features that could be viewed as components of such values, we have added language to eliminate to possibility that the exception could apply to anything other than cash surrender values themselves. To allow the language of the definition of "side fund" to admit of the possibility that not only cash surrender values but also other elements

characterized as part of a cash surrender value could be excepted would be to allow the exception to swallow the rule.

As long as they satisfy required minimums specified in the Standard Nonforfeiture Law, insurers can in the calculation of cash surrender value that is provided in their policy language take into account whichever policy features they choose, including funds or reserves that themselves qualify as "side funds." In this way a fund or reserve which would in the ordinary course qualify as a side fund could be accurately be characterized as part of a cash surrender value. Thus, if the definition of "side fund" were allowed to remain susceptible to the interpretation that policy features that are only part of a cash surrender value (and not themselves cash surrender values) also fall within the exception for cash surrender values, any fund or reserve could escape the definition of "side fund" simply by being included in the calculation for cash surrender values provided for in policy language. Merely by drafting the right policy language, insurers could effectively ensure that there would never be any such thing as a side fund under the regulations, since nearly any policy feature could conceivably be characterized as "part of" a cash surrender value.

Of course side funds do exist. The abuses associated with them are among the principal reasons Congress acted and the NAIC drafted model regulations. Any protection that might be afforded by the Standard Nonforfeiture Law for Life Insurance is defeated by the deceptive policy provision, prohibited by the regulations, specifying that insurance premiums will by default be paid using money in the side fund when the service member stops making premium payments, until the policy finally lapses and the service member is left with nothing. This prohibition would be utterly ineffective if side funds could escape categorization as such under the regulations. For these reasons we have inserted language into the Amended Text of Regulation that ensures that only cash surrender values provided by a whole life policy themselves, and not components of a cash surrender value, qualify for the exception for cash values. The inserted language also precludes, for the same reasons, any similar misinterpretation with respect to the first exception from the definition of side fund: the exception for accumulated value, cash surrender value and secondary guarantees provided by universal life policies.

Also to correct a clarity problem present in the model regulation and in the originally noticed Text of Regulation, we have inserted the word "and" into the first sentence of Subdivision (n) of Section 2695.24, the definition of "side fund." Previously the relative pronoun "which" could have referred to the word "mechanism," the phrase "life insurance policy" or the phrase "fund or reserve." The insertion of the conjunction "and" eliminates this ambiguity by making it syntactically impossible for "which" to refer either to "mechanism" or to "life insurance policy." In the Amended Text of Regulation, the only possible antecedent for the pronoun "which" is "fund or reserve." This editorial change makes the text consistent with the obvious intent of the drafters of the model. The job of this subdivision is to define "side fund," and one of the seminal features of a side fund is that it "accumulates deposits with interest or by other means." Clearly the "mechanism" by with the fund or reserve is attached to the life insurance policy cannot be said to "accumulate premium." And if a "life insurance policy" can be said to "accumulate premium with interest or by other means," then this characterization could apply to all life insurance policies. But since the purpose of this definition, like any definition, is to narrow down the range of possibilities so as to define one particular thing and distinguish it from other

things, the subordinate clause "which accumulates premium with interest or by other means" would add nothing if it modified the phrase "life insurance policy." The fact that neither of the commenters at the fifteen-day notice stage complained of this change indicates that the changed text is consistent with their interpretation of the model regulation.

Nonsubstantive changes have also been made to the regulation text. As indicated in the Amended Text of Regulation, we have inserted into Paragraph (e)4 of Section 2695.26 a parenthetical citation to the Act which will allow the document to be located more readily by means of electronic legal research software. The following nonsubstantive changes were not indicated in the Amended Text of Regulation: In Subdivision (c) of Section 2695.23 we have changed the word "subsection" to "subdivision" and now refer to the subdivision using its complete designation (as "subdivision (c)") the first, instead of the second, time the subdivision is referenced; we have deleted a colon that was not indicated as deleted in the Amended Text of Regulation, immediately preceding Paragraph (n)1 of Section 2695.24; and into Subdivision (o) of Section 2695.24 we have inserted the word "appointment," which was present in the model regulation but was inadvertently omitted from both the originally noticed Text of Regulation and the Amended Text of Regulation.

UPDATE OF MATERIAL RELIED UPON

No material other than public comments, the transcript of the public hearing, the Notice of Availability of Revised Text, the Amended Text of Regulation, the declaration of mailing therefor, the Redline Showing Changes to NAIC Model Regulation including 15-day Changes and Subsequent Nonsubstantive Changes, this Final Statement of Reasons and the Final Text of Regulations has been added to the rulemaking file since the time the rulemaking record was opened, and no additional material has been relied upon.

MANDATE UPON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Department has determined that the proposed regulations will not impose a mandate upon local agencies or school districts.

ALTERNATIVES

The Commissioner has determined that there are no alternatives that would be more effective, or as effective and less burdensome to affected persons, than the proposed regulations. In support of this determination is the fact that no such alternatives were suggested during the public comment period, despite the express invitation therefor that was extended in the Notice of Proposed Action.

SUMMARY OF AND RESPONSE TO COMMENTS

Commenter	Synopsis or Verbatim Text of Comment	Response
Prescott Cole, California Advocates for Nursing Home Reform [Tab Y]: Synopsis	Enthusiastic support for the regulations generally	Thank you.
John Metz, JustHealth [Written comments (Tab Z) and testimony at hearing]: Synopsis	At the hearing and in his written comments, the commenter takes issue with language in the Notice of Proposed Action. Specifically, he identifies various ways in which the regulations could theoretically be economically beneficial and suggests that the notice should have identified these hypothetical salutary effects. Mr. Metz indicates that in the notice the Department has identified an insurer that received approximately $14 million in premium in 2006. He points out that if the company is in fact engaged in the practices prohibited by the regulations, it is already in violation of existing California law. Mr. Metz asserts that prohibiting the practices identified in the regulations will invigorate the insurance industry in general, since the industry as a whole is based on trust and peace of mind. Mr. Metz urges the Department immediately to institute enforcement actions against and revoke the certificates of authority of any insurers of which the Department is aware that engage in the predatory sales practices identified in the regulations. He asserts that the Department is legally required to do so. Mr. Metz's written comments consist of redlines indicating his suggested changes to the notice and text. In addition to his suggested changes to the cost impact estimates mentioned above, the commenter suggests (1) the following Insurance Code sections be added to the	The comments regarding the notice language amount to little more than supposition and conjecture. Other comments made by Mr. Metz are irrelevant because they are not specifically directed at the proposed action or to the procedures the Department has followed in proposing it. Mr. Metz may well be correct in some of what he says, but he offers no factual support for his assertions. The Department stands by the statements and estimates in the Notice of Proposed Action. As stated in the notice, the Department estimates that a domestic insurer which received approximately $14 million in premium in 2006 may be adversely affected by the regulations; however, we have not identified this insurer by name. We agree with Mr. Metz, however, that the practices identified in the regulations are each violations of existing California law. (1) No change. The regulations do not interpret Insurance Code section 790.1. Section 791.02 is already listed in the reference note. Sections 12921(a) and 12926 obligate the commissioner to enforce the Insurance Code. Nothing in the regulations interprets these sections or specifies when the commissioner will or will not take action. (2) No change. Sections 12921(a) and 12926 do not grant rulemaking authority. (3) No change. While we understand the objection to this language (it is contrary to

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	reference note of each section of the regulations: 790.1, 791.02, 12921(a) and 12926. Additionally, Mr. Metz indicates that (2) Sections 12921(a) and 12926 should have been identified in the notice as providing rulemaking authority. He also indicates that (3) the exemption (appearing in subdivision (c) of Section 2695.23) for general advertisements, direct mail, internet marketing and telemarketing, which exemption is present in the model regulation, should be deleted. The commenter suggests (4) changing in Subdivision (a) of Section 2695.24 the definition of term "active duty" to include members of the reserves serving under orders specifying less than thirty-one days, when these members of the reserves are excluded from the definition of "active duty" in the model regulation. Mr. Metz also suggests that the Department diverge from the model regulation by (5) making the following insertion into the definition of "known" or "knowingly" appearing in Subdivision (h) of Section 2695: "Known" or "knowingly" means, depending on its use herein, the insurance producer or insurer had actual awareness, is charged with actual awareness, or in the exercise of ordinary care should have known, at the time of the act or practice complained of, that the person solicited is a service member. (6) Mr. Metz corrects an omission by inserting into the definition of "specific appointment" in Subdivision (o) of Section 2695.24 the word "appointment." The commenter finally suggests departing from the model regulation by (7) adding the following language in seven locations in the regulation, at the end of each list of acts or practices that are declared to be false, misleading, deceptive or unfair: Making any statement to any active duty military service member, or presenting to any active duty	the Fair Practices Act), we have elected to remain consistent with model regulation in this instance. We believe the second sentence of the proposed regulations (Section 2695.20), which we have inserted, is sufficient to preclude the language Mr. Metz indicates should be stricken from being construed as a license to make misleading statements in general advertisements, direct mail, internet marketing and telemarketing. (4) No change. Again we have elected to remain consistent with the model regulation here. The exclusion of certain reservists from the definition of "active duty" in these regulations does not mean that insurers and producers may violate existing law with respect to them. See the second sentence of the proposed regulations (Section 2695.20). (5) No change. We have elected to remain consistent with the model regulation. We are unsure what, if anything, the proposed language would add, because it is unclear how it would sweep in any more situations that the "should have known" language presently does. (6) Thank you. This word was of course present in the model regulation. Owing to an editorial oversight the omission was not corrected in the Amended Text of Regulation. However, we will insert it into the Final Text of Regulation as a nonsubstantive change. The fact that Mr. Metz was able to correct the omission apparently without reference to the model supports our belief that this was the obvious meaning of the noticed text. (7) No change. We yet again have elected to remain consistent with the model regulation. Additionally we do not think this language is appropriate for regulations that, among other things, attempt to interpret and *make specific* language in the Fair Practices Act, since it essentially repeats the proscription found in Insurance Code section 790.03. Moreover, we don't know why it would

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	military service member any document that contains any statement, that contains any false, misleading, or deceptive information about any material fact.	be desirable to exclude misrepresentations of other than material facts.
Barbara Woodbury, TransWorld Assurance Company [testimony at hearing]: Synopsis	The commenter states that Mr. Metz's comments do not apply to all insurers and expresses general support for the regulations. Ms. Woodbury expresses the wish that the Department would hear more from the military than from consumer advocates. She is concerned that service members are not able to speak freely in public fora.	Some of the comments made by Ms. Woodbury are irrelevant because they are not specifically directed at the proposed action or to the procedures the Department has followed in proposing it. However, we too would have preferred to hear more from military personnel. The notice was sent to the Pentagon but the Department of Defense did not participate in these proceedings. The commenter may have a point that individual service members might be unable or reluctant to participate. However, the GAO report (Tab K) and the NAIC reports to Congress (Tabs G and J) contain information obtained from service members that was instrumental in the process by which the regulations were formulated.
Dan Brown, Sonnenschein Nath & Rosenthal, 12/10/07 [Tab 1]: Verbatim, but with inserted parenthetical numbers keyed to responses indicated in blue	On behalf of Trans World Assurance, a California domiciled life insurance company("TWA"), and American Fidelity Life Insurance Company, a Florida domiciled life insurance company ("American Fidelity"), I want to thank you and your colleagues for your hard work in addressing what had become a critical issue in the marketplace. We believe the draft regulations regarding the sale of insurance to military personnel proposed by the California Department of Insurance will protect California consumers from predatory practices that (1) other insurance companies and producers had implemented, while simultaneously allowing military personnel of all ranks the ability to choose among many quality products and services offered by qualified and compliant insurers. Neither company has any suggested revisions to the draft regulations proposed by the Department, although both companies continue to believe that consumers, whether	Some of the comments made by Mr. Brown are irrelevant because they are not specifically directed at the proposed action or to the procedures the Department has followed in proposing or adopting the regulations. Nor does Mr. Brown make recommendations for changing the regulation text as originally proposed. Nonetheless we respond as follows to certain of Mr. Brown's statements: (1) There is no evidence in the record, other than Mr. Brown's assertions and those of Ms. Woodbury, to suggest that the insurers Mr. Brown represents do not engage in the behavior the regulations are intended to curb. Mr. Brown has not, for instance, submitted for inclusion in the rulemaking file examples of policy forms embodying the products sold by the insurers he represents. (2) Neither the model regulation nor the proposed regulations go beyond the scope of Congressional intent

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	military or civilian, should have the freedom to choose any product available in the marketplace. TWA and American Fidelity fully support the federal mandate contained in the Military Personnel Financial Services Protection Act, Pubic Law 109-290 (the "Act"). In particular, the companies agree that "the brave men and women in uniform deserve to be offered first-rate financial products in order to provide for their families and to save and invest for retirement," and that they deserve to be protected from "dishonest and predatory sales practices." Act §§ 2(2), 9(a)(1). The companies also understand that (1) certain other insurers offered substandard and potentially confusing products. As such, both TWA and American Fidelity were actively engaged in and supportive of the process by which the National Association of Insurance Commissioners ("NAIC") adopted its model regulations regarding the sale of insurance to military personnel, which model became the basis for California's proposed regulations. (2) While the companies believe the final form of the NAIC model regulation goes beyond the mandate of Congress and may unduly limit the right of military personnel to choose from the same products as their civilian counterparts, we embrace the spirit of the regulations in protecting consumers from predatory sales practices. California's proposed regulations appropriately target and prohibit the types of marketing activities and substandard products that plagued certain portions of the military sales marketplace, without preventing military personnel from making informed choices about many appropriate and valuable products and services. (3) Moreover, both TWA and American Fidelity applaud California's expansion of these protections to <u>all</u> military personnel, as opposed to limiting the applicability to	as specified in the Act. Section 9 of the act states that is it Congress's intent that "the States collectively work with the Secretary of Defense to ensure implementation of appropriate standards to protect members of the Armed Forces from dishonest and predatory insurance sales practices while on a military installation of the United States (including installations located outside of the United States)." Section 11 of the Act specifically announces Congress's intent that the NAIC address: "standards for products specifically designed to meet the particular needs of members of the Armed Forces, regardless of the sales location." The deceptive and misleading products the regulations address are targeted specifically at military personnel, and not at civilians. The Department, too, would prefer that insurers treat members of the military no differently than they treat civilians in this regard. (3) Thank you. (4) This is an interpretation of the model regulation we had not foreseen. The model regulations and the originally proposed regulations except from the definition of side fund "cash values provided by a whole life policy which are subject to" the standard nonforfeiture law for life insurance. We had not considered the language of the model susceptible to the interpretation that funds or reserves that are merely "part of" such a cash value would be included in the exception. However, in order to eliminate any possible ambiguity in this regard we have in the Amended Text of Regulation added language that makes it explicit that only funds or reserves which themselves are nothing other than such a cash value fall within the exception. The added language also states, in no uncertain terms, that for purposes of this exception it is irrelevant whether or not the fund or reserve in question is

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	certain lower rank personnel. (This was a change that the companies proposed during the NAIC rule-making process, but the NAIC rejected the suggestion.) TWA and American Fidelity have already made certain adjustments to ensure that their sales practices comply with both the spirit and letter of the NAIC model regulations, and the California regulations when they take effect. For example, many of the abuses that gave rise to the Act, the NAIC model, and the California regulations occurred in the context of other insurers selling their products on military bases. To avoid even the appearance of impropriety, neither TWA nor American Fidelity conduct any sales activities on military bases. In addition, neither TWA nor American Fidelity sell the type of products that gave rise to the Act and the regulations, insofar as (4) neither company's products include a "side fund" as defined in the NAIC model regulations or the proposed California regulations because the accumulation fund is part of the cash value of the whole life policy and is subject to California's nonforfeiture laws. (5) These characteristics of the companies' accumulation fund have been reviewed multiple times over many years by the California Department. In short, both companies already comply with, or by the effective date will comply with, all applicable aspects of the currently proposed form of California regulations. Thank you again for pursuing these important regulatory provisions, and please contact me if we can be of any assistance in this process.	"part of" or is otherwise taken into account in the method by which cash values are calculated. (5) Again, no evidence is cited in support of this assertion. The Department of Insurance does not have policy approval authority over nonvariable whole life policies.
Brad Wenger, ACLHIC; John Mangan, ACLI; and Ted Angelo,	We are writing to you on behalf of the American Council of Life Insurers (ACLI) and the Association of California Life and Health Insurance Companies (ACLHIC). ACLHIC is the California trade association for life insurers and ACLI is the national trade association	Some of the comments made by Mssrs. Wenger, Mangan and Angelo are irrelevant because they are not specifically directed at the proposed action or to the procedures the Department has followed in proposing or adopting the regulations. We have made no changes to

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ACLHIC, 12/10/07 [Tab 2]: Verbatim, but with inserted parenthetical numbers keyed to responses indicated in blue	of 373 member companies who account for more than 90% of all annuity and life insurance premium written in California and the nation. We appreciate the opportunity to comment on the Department's proposed rules regarding sales to military personnel. First, we applaud the Department's (1) stated intent to adopt the NAIC Model regulation, which was unanimously approved by state regulators with the support of the life insurance industry. We strongly agree with the Department's statement regarding consistency with Congressional intent and state-to-state uniformity: *'To the extent that the proposed regulations contain the provisions of the Model they are reasonably necessary not only in order to carry out the intent of Congress but also in order to facilitate an efficient and consistent regulatory framework governing sales to military personnel on a nationwide basis.'* Our organizations worked with Congress and the NAIC to address concerns raised about misleading and predatory sales practices on military installations. Congress envisioned uniform adoption of these protections and the NAIC rightly created a consensus, uniform rule to achieve this goal in the states. We fully support the uniform adoption of state regulations on military sales that reflect the intent of federal legislation. However, our review of the proposed rule indicates that it is substantively inconsistent with the NAIC Model regulation. Some of these substantive deviations are acknowledged in the Department's Statement of Reasons, while others are not. We would respectfully urge the Department to conform these substantive provisions to the NAIC Model regulation. **Elimination of "E-4 and below" References** We did not see a reference in the Statement of	the proposed action to accommodate the suggestions contained in this comment. Our reasons for making no change, together with our responses to other statements contained in the comment, are set forth below. (1) Nowhere has the Department indicated that it intends to adopt the model regulations without modification. (2) Not all compromises reached at the NAIC are sufficient to satisfy the necessity standard of California's Administrative Procedure Act. There is required to be a rational basis for each provision of a California regulation. The distinction between service members with a pay grade of E-4 and other service members strikes us as somewhat arbitrary. Accordingly we have chosen to jettison the distinction. (2⅓) "Consensus" appears not to have been reached, since both Virginia (the State which after California has the highest number of military personnel [see Tab J, page 8]) and Florida, for instance, have also eliminated the E-4 distinction in the regulations they adopted. To view the Florida regulations, go to the following URL: https://www.flrules.org/gateway/ruleNo.asp?ID=69o-142.200 To view the Virginia regulations, go to the following URL: http://docket.scc.virginia.gov:8080/vaprod/main.asp In the "SEACH CASES" field, enter "INS-2007-00268"; click the "SEARCH" button at right. Then, click the case number you entered. Then, click "Documents." (It will be the second document listed.) (2⅔) The Department of Defense itself opposes the E-4 distinction. See Tab G, page 41. (3) False, misleading or deceptive practices are illegal no matter whom they are practiced upon. By "combination products" the commenters can only mean life insurance

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	Reasons to the elimination of "E-4 and below" pay grades, but we have serious concerns about the elimination of this substantive model provision. By eliminating all references to service members with a pay grade of "E-4 or below," the (2) Department's proposed rules go against the agreed-upon intent of the model regulation, which was carefully worked out during the discussions between regulators and our industry. The application of the NAIC Model only to service members with a pay grade of E-4 or below was an important part of the (2⅓) consensus reached on the model rule. This provision also comports with existing (2⅔) Department of Defense regulations, as well as the Military Personnel Financial Services Protection Act of 2006. The rationale for taking this approach is as follows: ~(3) The vast majority of the false, misleading or deceptive practices and unsuitable sales (combination products) were reported to be among those of a rank of E-4 and below. ~Conversely, (4) it was deemed unnecessary to presume unsuitability for, and apply a higher standard to establish suitability to, those service men and women who are older, more established, of higher rank and who have far more extensive financial obligations and considerations. ~(5)Army Regulation 210-7, overtly recognizing the vulnerability of the lower-rank, recent-enlistee population, requires that those of a rank of E-4 and below must first receive counseling, "preferably by an officer," about the need for additional insurance before a discretionary allotment is processed. ~(6) The Army recognizes the need for guidance among the lower ranks but also strongly presumes an officer can manage on his or her own, similarly situated financial decisions and/or opportunities. ~(7)With the exception of combination products, offering	policies that include a side fund, since these are the only products the sale of which is presumed to be unsuitable in the regulations. Section 2695.26, subdivision (f). We know of no reason why service members with pay grades above E-4 should not also receive the protection against unfair trade practices and other violations of law that is afforded by this presumption with regard to products that include such a policy feature. (4) Again we are unsure why individuals who are "older, more established, of higher rank and who have far more extensive financial obligations and considerations" are significantly less likely to be victimized. (5) Apparently not all officers possess the savvy the commenters attribute to them, because at least some of these officers appear to have been unable to provide counseling that would have protected the E-4s and below from falling prey to the predatory and deceptive behavior that is the subject of the regulations. Otherwise there would have been fewer abuses reported among Army personnel. (6) If "the Army" is in favor of the E-4 distinction, it is at odds with the Office of the Under Secretary of Defense. See Tab G, page 41. (7) Precisely so. We therefore question why the regulations should not apply to all service members, regardless of rank, with regard to these areas as well. (8) If individuals of higher rank indeed do have a legitimate need for life insurance over and above what is provided by the official, subsidized SGLI program, then insurers will be able to overcome the presumption of unsuitability with respect to those sales. (9) Sections 2695.25, 2695.26 and 2695.27 are the only sections that actually proscribe given acts or practices. Consequently, exemption from these sections only is

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	inducements to attend off-base sales presentations, and giving certain tax advice, the Model Regulation applies to all service members regardless of rank. (8)Unlike E-4 and below, those of a higher rank are more likely to have a need for additional life insurance. E-4 and below are typically young and unmarried with few financial obligations. For these reasons, ACLI respectfully requests the proposed rule be amended to apply to pay grades E-4 and below in accordance with the NAIC Model. **Other Substantive Deviations from the Model** As noted in the Statement of Reasons, the Department has made other substantive changes to the model rule. We oppose all these deviations from the model. We have particular concern about the following provisions: ~The proposal limits application of the exemptions only to certain sections of the proposed regulation proscribing given acts or practices. (9) This change is contrary to the intent and operation of the model regulation, under which the exemptions rightly apply to all elements of the regulation. We urge that this change be removed. ~The exemption for group life insurance products has been limited in the proposal to products where there is no face-to-face solicitation of individuals by an insurance producer ***and*** the contract or certificate does not include a side fund (the Department's proposal uses the word "and" in place of the word "or" used in the Model Regulation). (10) We strongly oppose this change, which is a clear deviation from the Model Regulation. We also disagree with the Department's rationale for this change, which appears to be based on a statement made by Bill Goodman and recorded in the minutes of an NAIC conference call with industry officials and the ACLI on April 19, 2006. There are three	sufficient to ensure that the exempted classes, lines and products are not impacted by the substantive prohibitions present in the proposed regulations. Additionally, as pointed out in the Initial Statement of Reasons, exempting only certain classes, lines and products from the purview of Subdivision (*l*) of Section 2695.24, which, as pointed out in the notice, is to apply beyond the proposed regulations, could cause the regulations to run afoul of the clarity standard of the APA. The term "premium deposit fund" could have two separate meanings, depending, for instance, on whether or not the group life policy in question was sold by means of face-to-face solicitation. (10) Actually, we replaced the two words, "or where" with the word "and." At any rate our change cannot be a clear deviation from the model, since it is not at all clear precisely what the model meant in the first place. In the minutes of the Military Sales (EX) Working Group conference call of April 19, 2007 [Tab H], Bill Goodman, who co-chaired the meeting, indicated that the Model "covers group policies that are solicited face-to-face but does not apply to other group policies." This statement suggests that it was his understanding that face-to-face contact alone would cause the model to apply, whether or not a side fund was part of or attached to the policy being sold. The language of the model is susceptible to an interpretation that is consistent with Mr. Goodman's statement. (11) The commenters do not cite evidence that the committee was persuaded by comment letters received subsequently. (12) Since the regulations concern only life insurance policies, the only kind of group policies to which Mr. Goodman could have been referring when he mentioned group policies was group life policies. The

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	problems in relying on Mr. Goodman's statement: (1) (11) the comment period was not over on April 19, 2006 and ACLI and others argued in later comment letters against his position; (2) (12) his position is not appropriate with respect to group life insurance, particularly group term life insurance; and (3) (13) the language of the Model as adopted by the NAIC does not agree with his statement. (14) The final language of the Model Regulation is clear and unambiguous. (15) We believe the intent of the NAIC was indeed to exempt group life insurance products, particularly group term life insurance products, where there is face-to-face solicitation, but there is no side fund. (16) These plans were not the subject of Congressional or NAIC concern. Such plans, particularly group term life insurance plans, involve low premiums (and (17) thus low commissions and low incentive for agent abuse) for high face amounts of term life insurance coverage. (18) They have not generated the types of complaints or scrutiny that led to federal action, and can be of substantial benefit to military families. Thus, we urge the department to return to the model provision. ~(19) The proposal requires that life insurance products sold to members of the military must comply with the Standard Nonforfeiture Law for Individual Deferred Annuities and the Standard Nonforfeiture Law for Life Insurance. Once again, we oppose these deviations from the Model Regulation. (20) There is no basis in the Model Regulation for imposing the Standard Nonforfeiture Law for Individual Deferred Annuities on premium deposit funds. (21) In addition, there are clearly term life insurance products (including some group life insurance products as	commenters give no reasons here why group life or group term life policies are not subject the kinds of abuse as other life policies. (13) To the contrary, the language of the model can be read to say that only group life policies where there is no face-to-face contact or side fund are exempt. Thus, the presence of either face-to-face contact or a side fund disqualifies the transaction from receiving the exemption. This is probably the most likely meaning and is consistent with Mr. Goodman's statement. (14) Again, we disagree. The language of the model is susceptible to the reading the commenters advocate. Consequently the language is ambiguous and, as a matter of law, presumed unclear. (15) The commenters have submitted no evidence in support of this assertion. But note that if the model language means what they contend it does, then group life policies that have a side fund would also be exempt, if they were sold by means other than face-to-face solicitation. This result is inconsistent with the model's extra protections with regard to products that have side funds. (16) Again, the commenters cite no evidence that group products were not part of the problem to which Congress reacted. Bill Goodman's statement is itself evidence that there was concern at NAIC about group products. (17) One wonders why, if indeed the commissions are so low and there is therefore so little incentive for abuse, agents would find it worth their while to engage in face-to-face solicitation in the first place. One way face-to-face solicitation might be made cost-effective in such a circumstance, one supposes, would be for service members to be effectively rounded up and solicited en masse in the ways identified in the regulations. We

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	noted above) that are not now, and should not be, subject to the Standard Nonforfeiture Law for Life Insurance. (22) Imposing that law on these products would actually conflict with current California law. Our members are committed to the adoption of the NAIC Model's strong, comprehensive regulation of sales to military personnel. We respectfully urge the Department to delete the substantive variations from the model. Please let us know if you would like further information.	suspect that where there is sufficient incentive to perform face-to-face solicitation there is also incentive for abuse. (18) The commenters do not claim that group term life products have not generated complaints or scrutiny, just not the same types or scrutiny that lead to federal action. Nonetheless, we agree that group term life products can be of substantial benefit for military families. The Department has rejected a suggestion received from another commenter that the exemption for general advertisements, direct mail, internet marketing and telemarketing that is present in the model be deleted from the proposed regulations. Accordingly the regulations contain no proscription against marketing by any of these means group term life policies that do not have a side fund. There is, in fact, nothing in the proposed regulations to prevent an agent or insurer from marketing group term life polices by means of face-to-face solicition; the product and transaction merely need to avoid the egregious violations identified in the regulation. (19) It is not strictly true that the proposed regulations require that life products *comply* with the Standard Nonforfeiture Law for Deferred Annuities (Article 3B). (The proposed regulations identify as false, deceptive, misleading or unfair policies that violate the Standard Nonforfeiture Law for Life Insurance (Article 3A).) In Paragraph (f)4 of Section 2695.26 the regulations do, however, require insurers to *avoid violating* Article 3B. If Article 3B does not apply to a product in the first place, then the product cannot violate Article 3B. However, if a life product contains a component that can be characterized as a deferred annuity, then that component may be required to comply with Article 3B, and it is Article 3B and not these regulations that would require such compliance. (The regulations merely identify such

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		noncompliance as false, deceptive, misleading or unfair when the policy is sold or marketed to an active duty service member.) No component of an insurance product can be required to comply with both Article 3A and Article 3B simultaneously, since Article 3A does not apply to annuities. Ins. Code § 10165, subd. (d). However, all life insurance products, including annuities, must avoid violations of either Article 3A or Article 3B, and the requirement that they do so does not originate in the proposed regulations. (20) The regulations cannot and do not "impose" Article 3B on premium deposit funds. Premium deposit funds are expressly beyond the scope of Article 3B. Ins. Code § 10168. The Department does have rulemaking authority to define the term "premium deposit fund," however, so that not just any fund, reserve or account that someone happens to call a premium deposit fund qualifies as such and thereby gains exemption from Article 3B (and may qualify for the third exemption from the definition of "side fund." (21) It is the model, as well as the proposed regulations, that specifies that products that violate Article 3A are false, deceptive, misleading or unfair. However, if it is true that a product is not now subject to Article 3A, there is nothing in the proposed regulations that will cause it to be. (22) There may indeed have been a consistency problem if we had not changed "does not comply with" to "violates."
Dan Brown, Sonnenschein Nath & Rosenthal, 1/7/08 [Tab 7] :	On behalf of Trans World Assurance, a California domiciled life insurance company, and American Fidelity Life Insurance Company, a Florida domiciled life insurance company, thank you and your colleagues once again for your hard work in drafting and revising the	Some of the comments made by Mr. Brown are irrelevant because they are not specifically directed at the proposed action or to the procedures the Department has followed in proposing or adopting the regulations. We have made no changes to the proposed action to accommodate the

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Verbatim, but with [omissions] and inserted parenthetical numbers keyed to responses indicated in blue	proposed regulations regarding sales of life insurance to military personnel. We received the December 20, 2007, Notice of Availability of Revised Text, and hereby provide comments with respect to the revisions to proposed Section 2695.24. Unfortunately, we found the revised text to be confusing in its (1) intent, meaning, and (2) applicability. The proposed definition of a "side fund" went from a straightforward definition with three exceptions, to a definition with a sub-definition followed by three exceptions with two potentially negating internally (3) circular clauses for two of the exceptions. This series of revisions appears to result in the same substantive application as the previous draft, but only after (4) an additional series of analysis and not with clarity. The effect of these proposed changes, therefore, would be to confuse (5) consumers, (6) make it extremely difficult for industry participants to know if they were compliant, and (7) create enforcement impediments and ambiguities for the Department of Insurance. We continue to support the prior version of the proposed regulation, which was based on the Model Regulation adopted by the National Association of Insurance Commissioners ("NAIC") and which was (7½) unopposed at the public hearing on the regulation. In the following sections we describe why [we] believe the revised text to be unclear and confusing, and we propose solutions. <u>Lack of Clarity of the Proposed Revisions</u> The initial draft of California's proposed regulation (similar to the model regulations adopted by the NAIC, which California, via its NAIC membership, committed to adopt in substantially the form promulgated by the NAIC) stated in relevant part as follows: [accurate quotation from the originally noticed Text of Regulation omitted]	suggestions contained in this comment. Our reasons for making no change, together with our responses to other statements contained in the comment, are set forth below. (1) There is no requirement that the intent or intention underlying regulatory language be manifest in the text itself. This Final Statement of Reasons is the source of information as to the Department's intent in amending the regulations. (2) The changes we have made to Subdivision (n) of Section 2695.24 do not alter the applicability of the definition of "side fund." The scope of the regulations is specified in Section 2695.21. (3) The logic of the added language is impeccable. The language steers the analysis of every conceivable case inexorably to one or the other very definite conclusion. For this reason there is no circularity. (4) The added language requires no additional analysis. It may, however, require the reader to refer back to the results of analyses that under the model already had to be performed. (5) Much of Chapter 5 of Title 10 would confuse consumers, but necessarily so since it governs an industry the workings of which would mystify most people. The clarity standard of the APA requires only that regulations be able to be easily understood by those directly affected by them. The only people who will be directly affected by the definition of "side fund" are insurers and the Department. 1 Cal. Code Regs. 16. (6) The changes complained of do not make it significantly more difficult for insurers to know if they are compliant than would have been the case under the model. Insurers are among the most sophisticated of business entities and have at their disposal the very finest lawyers. Very long attention spans and extremely high reading

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	This concise and clear definition, similar to the definition adopted by the NAIC,is written in plain, straightforward language, is easily readable, and (8) permits regulated persons and consumers to identify whether certain products (18) are or include a "side fund." There is a single definition, with straightforward (9) criteria to determine whether a product falls within that definition. This straightforward and understandable approach, however, is not adopted in the proposed revisions. For convenience, the December 20, 2007, proposed text is set forth in relevant part below: [accurate quotation from the Amended Text of Regulation omitted] This longer and quite (10) convoluted definition does not (10¼) appear to add any (10½) substantive protections for consumers, does not appear to alter the scope of products to which the regulations apply, is internally (3) circular, and requires a (11) multiple-step process to (12) even tentatively determine whether a product in fact (18) is or (14) has a "side fund" subject to the regulations. Due to the (3) circular nature of the exceptions to the exceptions as described below, the revised text (10¼) appears to do nothing more than the much shorter and (15) more clear version of the definition that was proposed on October 26, 2007, and to which (7½) no constituents objected at the hearing on December 10, 2007. For example, assume that a company has a duly filed and (16) approved universal life insurance policy that it sells to consumers. To determine whether this product is regulated under the proposed regulations as a "side fund", the company and the Department would need to go through the following steps: 1. (17) Determine whether the product includes a fund or reserve that is part of or otherwise attached to the universal life policy which accumulates	comprehension ability can therefore justifiably be ascribed to insurers. (7) To the contrary, any impediments to enforcement with regard to the exceptions to the definition of "side fund" are substantially reduced by the new language. This is because the revised language eliminates ambiguity of the type identified to the Department by the commenter in his letter of December 12, 2007: Do the exceptions apply to funds or reserves that can accurately be characterized as part of the values named in the exemptions, or do they not? If any ambiguity is present, it is present in the originally noticed text and not in the Amended Text of Regulation. (7½) There is no requirement that the Department make changes to proposed regulations only in response to opposition at the hearing. (8) As has been pointed out, the language of the model was susceptible to multiple readings. It therefore allowed confusion over which funds or reserves constitute side funds. (9) The definition of side fund in the model contained no criteria. In the Amended Text of Regulation criteria have been added for the purpose of determining with certainty whether or not the first two exceptions apply. (10) Certainly the language can fairly be characterized as extremely involved; intricate; complicated. It must of necessity be complex, though, in order resolve all ambiguities as to which funds or reserves qualify under the first two exceptions in the definition of "side fund." (10¼) It is perhaps true that to someone who were unaware of the argument that an exception applies if the fund or reserve in question is not the value or guarantee that is actually excepted but is part of the value or guarantee excepted — that to such a person the changes

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	premium or deposits with interest or by other means. Assuming the universal life policy has such a fund or reserve, (18) it is defined as a "side fund." 2. Because the (18) policy constitutes a "side fund," it also (18½) necessarily constitutes a "presumptive side fund" under the definition. ((19) Every "side fund" is also a "presumptive side fund," which appears to make the additional definition (20) unnecessary.) 3 (17) Determine whether the (14)(18)(20½) universal life policy provides accumulated value, cash surrender value, or secondary guarantees. Assuming the universal life policy provides such benefits, (18) it is not a "side fund." 4 Notwithstanding the fact that the (18) universal life policy is not a "side fund" based on Step 3 above, it will nonetheless revert back to being a "side fund" unless (18) it (19) is (a) an accumulated value, cash surrender value or secondary guarantee provided by a universal life policy, or (b) otherwise exempted from the "side fund" definition by another paragraph of the definition. (20) It is (21) unclear, however, how a universal life policy could satisfy the criteria for Step 3 above (paragraph (n) (1) of the revised draft regulation) but not also satisfy the criteria for Step 4 (a) above (subparagraph (n) (1) (A)of the revised draft regulation). This would result in (22) the same substantive results as the previous draft of the proposed regulations and as the NAIC Model Regulation, (23) in which case the revisions are not necessary. If different substantive results are (1) intended, it (24) is not clear how that is achieved in revised paragraph (n)(1) or (25) what the extent of the change would be. In short, the	would "appear" not to alter the meaning of the existing language. However, in such a case, whether or not there "appeared" to be a change would be utterly irrelevant, when the new language effectively makes clear that the above-mentioned argument is of no effect, as is the case here. (10½) The added language does not purport to add any substantive protections for consumers. Rather, it prevents certain funds or reserves from escaping characterization as a "side fund" under the regulations. The substantive protections for consumers are enumerated elsewhere. The added language does, however, unequivocally rule out the possibility that the first two exceptions might apply not only to the values or guarantees named in the exceptions but might also apply to funds or reserves that are taken into account in the calculation of such values or guarantees. (11) (12) The revised text does not require more steps than did the originally proposed text to reach the "tentative" exception. The additional steps are required in order to confirm that the exception does in fact apply. (13) (omitted) (14) The definition of "side fund" in the model, in the originally proposed regulations and in the amended regulations focuses on the fund or reserve itself and not, as is suggested here, on the life policy to which the fund or reserve is attached. If the fund or reserve matches the description in the definition, the fund or reserve is a "side fund." (15) The originally noticed version was not clear. The revised text eliminates the potential ambiguity to which the Department was alerted by the commenter's letter of December 10, 2007. (16) Whether or not a policy is approved has nothing to

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	(26) multiple steps with respect to this potential exception are unclear and appear to be (27) circuitous, leaving (28) uncertainty with respect to which products are, or (1) are intended to be, included or excluded by the newly-complex definition. Similarly, assume that a company has a duly filed and (16) approved (29) whole life insurance policy that it sells to consumers, and that (30) it includes as part of the cash value of the policy a fund or reserve into which insureds can deposit funds to accumulate with interest. To determine whether this product is regulated under the proposed regulations as a "side fund", the company and the Department would need to go through the following steps: 1 (17) Determine whether the product includes a fund or reserve that is part of or otherwise attached to the whole life policy which accumulates premium or deposits with interest or by other means. Assuming the whole life policy has such a fund or reserve, (18) it is defined as a "side fund." 2 Because the (18) policy constitutes a "side fund," it also necessarily constitutes a "presumptive side fund" under the definition. (18½) 3 (17) Determine whether the (14)(18)(30½) whole life policy's cash surrender values are subject to California's nonforfeiture laws. Assuming the whole life policy is subject to such nonforfeiture laws, (18) it is not a "side fund." 4 Notwithstanding the fact that the (18) whole life policy is not a "side fund" based on Step 3 above, it will nonetheless revert back to being a "side fund" unless (18) it (19) is (a) a cash surrender value as described in Step 3, or (b) otherwise exempted from the "side fund" definition by another paragraph of the definition. (19½)	do with whether or not a fund or reserve that is part of the policy or to which it is attached constitutes a side fund under the regulations. (17) This step was required under both the model and the originally noticed regulations. Note, however, that the commenter omits the conjunction "and" which we have added in the amended text (discussed on pages 3 to 4 of this document). (18) Under all three definitions of "side fund," life insurance policies themselves are never side funds. In each case "side fund" is defined as "a fund or reserve that is part of or otherwise attached to a life insurance policy." In other words, the side fund is something other than the policy of which it is part or to which it is attached. This fairly simple concept was grasped by the commenter at the time he drafted his letter of December 10, where he states, "neither company's products *include* a "side fund." [Tab 1] (Emphasis added) (18½) This is correct, although it would have been more precise to say, "because the policy constitutes a side fund under the first sentence of the subdivision," it necessarily constitutes a presumptive side fund. (19) This too is correct, but not every presumptive side fund constitutes a side fund. (19½) Despite misinterpreting various steps along the way, the commenter has successfully navigated the supposedly confusing structure of the new language, arriving at each step in the correct sequence. (20) The additional language is indeed necessary, precisely for the purpose of ruling out funds or reserves that are merely part of an excepted value or guarantee: These funds or reserves are themselves something other than the values or guarantees named in the exception. Consequently they do constitute a side fund.

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	As with the universal life exemption, it is (21) unclear how a whole life policy could satisfy the criteria for Step 3 above (paragraph(n)(2) of the revised draft regulation) but not also satisfy the criteria for Step 4(a) above (subparagraph (n)(2)(A) of the revised draft regulation). This would result in (22) the same substantive results as the previous draft of the proposed regulations and as the NAIC Model Regulation, (23) in which case the revisions are not necessary. If a different substantive results are (1) intended, it is (24) not clear how that is achieved in revised paragraph (n)(2) or (25) what the extent of the change would be. As such, the (26) multiple steps for this exception are also unclear and appear to be (27) circuitous, leaving (28) uncertainty with respect to which products are, or are intended to be, included or excluded by the newly-complex definition. The Standard for Regulations The standards for drafting regulations are set forth in California's Government Code, as follows: "The agency shall draft the regulation in plain, straightforward language, avoiding technical terms as much as possible, and using a coherent and easily readable style." Cal. Govt. Code § 11364.2(a)(1). In addition, the Office of Administrative Law is required to review all regulations adopted by the Department "and make determinations using all of the following standards: ... Clarity..."Cal. Govt. Code § 11349.1(a). The term "Clarity" is separately defined as "written or displayed so that the meaning of regulations will be easily understood by those persons (31) directly affected by them." Cal. Govt. Code §11349(c). We believe the revised draft of the regulation fails to meet these drafting criteria. The previous definition, with its straightforward exceptions, was easily readable	(20½) Again, under none of the three versions of the definition does one ask this question about the policy. The inquiry is always focused on a particular fund in question that is part of or attached to the policy. It is a misinterpretation of all three versions of the definition that if a policy provides a cash surrender value, for instance, the fund or reserve in question is not a side fund. All the policies relevant to this discussion do provide cash surrender values, and are legally required to do so. So according to this misinterpretation, there is no such thing as a side fund. The thing that is excepted from the definition of side fund in all three versions is clearly the value or guarantee itself and not the policy that provides the value or guarantee. (21) To the contrary, it is perfectly clear at this point how a fund or reserve (and not the policy of which it is part or to which it is attached) can be a presumptive side fund yet still not be a side fund: The fund or reserve is itself nothing other that the value or guarantee named in the exception. In other words, if the fund or reserve in question is merely part of, or taken into account in the calculation of, such value or guarantee, then that fund or reserve is explicitly a side fund under the revised definition. (22) Under the previous draft it was possible to argue that a fund or reserve qualifies for the exception if it is part of, or taken into account in the calculation of, the value or guarantee. Under the revised text, this argument is no longer possible. (23) But as the result is in fact different, the changes are necessary. (24)(25) Both the effect of changed language and the mechanism the new language employs to achieve this effect are indeed clear.

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	and could be applied in a straightforward manner to various insurance products. The revised draft, however, as described above, is unclear as to its (1) intent, its (2) application, and whether it makes any (10½) substantive changes whatsoever to the ultimate (2) application of the prior draft of the regulations. If the Department (1) intended to make (10½) substantive changes to the scope of products affected by the draft regulations, the nature and extent of any such changes are not evident upon a close reading of the draft. Insofar as the (1) intent and (2) applicability of the revised draft is not apparent to people familiar with the industry, the revised impact on the products currently available is (32) not clear, and (33) [in light of] the extensive discussions with respect to the definition adopted by the NAIC, we respectfully submit that the (34) current draft of the regulations fails to satisfy the clarity requirement of Government Code sections 11364.2 and 11349.1. Alternative Text As indicated above, the (1) desired or (10½) actual substantive impact of the revisions is unclear from the text of the proposed regulations. As such, we request that the definition revert to the form and content which was (a) (33) extensively debated, discussed, revised, and ultimately adopted by the NAIC, (b) initially proposed by the Department on October 26, 2007, and (c) (7½) unopposed by any constituents at the Department's December 10, 2007, hearing regarding the proposed regulations. Alternatively, we would be happy to suggest revised text if the substantive intent of the changes were to be explained to us so we could work toward an easily understood definition. Thank you again for pursuing these important regulatory provisions, and please contact me if we can be	(26) "Multiple steps" are not unclear, as is evidenced by the fact that even the commenter could not find a way to stray from the path. (27) The language of the definition of side fund is as direct as it can be in order to achieve the result that has been identified time and time again in this Final Statement of Reasons. (28) No uncertainty is possible: The portions of products (not the products themselves) that now can no longer even arguably qualify for the exception are funds or reserves that are part of but are not themselves a value or guarantee named in the exception. (29) The Department cannot approve or disapprove nonvariable whole life policies. (30) This is the archetypical side fund. Under the new language, the fact that the fund or reserve is included in the cash [surrender] value does not allow the fund or reserve to escape the definition of "side fund" by means of the exception for cash [surrender] values, according to the new language. (30½) Again, under none of the three versions of the definition does one ask this question about the *policy*. The inquiry is always focused on a particular fund in question that is part of or attached to the policy. The question is not whether the life policy's cash surrender values are subject to the nonforfeiture law but whether the fund or reserve in question is a cash value that is subject to the nonforfeiture law. Under the new language it may in some cases not even be necessary to perform the analysis of whether the nonforfeiture law applies to the fund or reserve in question, since in order for a fund or reserve to qualify for the exception it must itself be nothing other than a cash surrender value in the first place. In the hypothetical posed by the commenter, the

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	of any assistance in this process.	fund or reserve in question is obviously something other than a cash surrender value. (It is a fund into which one can deposit money.) Accordingly the new language yields the correct result without the necessity of determining whether the nonforfeiture law applies. Even if the law did apply to this fund or reserve, it would still be a side fund under the amended text since it is simply not the case that the fund or reserve is "nothing other than a cash surrender value…". Only if the fund or reserve in question is itself nothing other than a cash value subject to the nonforfeiture law does it qualify for the exception. (32) Again, the amended text is sufficiently clear to sweep into the definition of side fund those funds or reserves that are not themselves the values or guarantees named in the exceptions but are instead only components of such values or guarantees. (33) Unfortunately the extensive discussions at NAIC are capable of yielding language that is patently unclear. See, for instance, Paragraph (f)5 in the model regulation. (34) To the contrary, the current language satisfies the clarity standard. The commenter has been unable to identity any vague or ambiguous words, phrases or references. None of the other problems that would cause the regulations to be presumed to fail of the clarity standard that are enumerated in 1 Cal. Code Regs. 16 are present. The language is indeed easily understandable by insurers, who are the ones who will be directly affected.
Ted Angelo, ACLHIC, and John Mangan, ACLI, 12/10/07 [Tab 2]: Verbatim, but with inserted	We are writing to you on behalf of the American Council of Life Insurers (ACLI) and the Association of California Life and Health Insurance Companies (ACLHIC). ACLHIC is California's premier trade association for life and health insurers, and ACLI is the national trade association of 373 member companies who account for more than 90% of all annuity and life insurance	(1)(2) Perhaps the commenters are unaware of the ambiguity that was brought to our attention by the letter from Dan Brown dated December 10, 2007. At any rate, this Final Statement of Reasons, and not the Amended Text of Regulation, is the place where this information is required to appear. (3) As has been pointed out, the thing the commenters

Commenter	Synopsis or Verbatim Text of Comment	Response
parenthetical numbers keyed to responses indicated in blue	premium written in California and the nation. We appreciate the opportunity to comment on the Department's amended text to the proposed rules regarding sales to military personnel. As stated in our original letter, we applaud the Department's stated intent to adopt the NAIC Model regulation, which was unanimously approved by state regulators with the support of the life insurance industry. Again, our organizations worked with Congress and the NAIC to address concerns raised about misleading and predatory sales practices on military installations. Congress envisioned uniform adoption of these protections and the NAIC rightly created a consensus, uniform rule to achieve this goal in the states. We fully support the uniform adoption of state regulations on military sales that reflect the intent of federal legislation. However, our review of the proposed rule indicates that it remains substantively inconsistent with the NAIC Model regulation. We respectfully urge the Department to conform these substantive provisions to the NAIC Model regulation. Specifically, the amended text to the proposed regulation offers new subsections that attempt to further define "Side fund" in 2695.24 (n). Our members are confused about the (1) need to do this, and are trying to understand the overall (2) intent of the new provisions. (3) We believe the proposed changes generally result in one substantive change; changing the term "cash value" to "cash surrender value." The term "cash value" does not take into account surrender charges that an insurer may impose if a policy is surrendered, while "cash surrender value" obviously would take those charges into account. We believe (4) the proposed regulation is saying the same thing as it did before - which is that regular	identify as cash surrender value is, with respect to a life insurance policy, is what is commonly understood to be meant by "cash value." Moreover, the terms "cash value" and "cash surrender value," when applied to life policies, consistently mean the same thing in the Insurance Code: the amount of money one is entitled to receive when one surrenders the policy. Finally, when the reference is to cash values subject to the Standard Nonforfeiture Law for Life Insurance, as is the case here, "cash surrender values"is clearly what is intended, since that law involves very little else but cash surrender values. However, the very fact that the commenters state that the two terms mean different things provides support for the necessity of our making the change. We have made it clear that the cash values that are excepted from the definition of "side fund" are cash surrender values and not other kind of cash values. (4) If we had not been made aware of the interpretation of the model regulations which allows a fund or reserve that is not itself one of the values or guarantees named in an exception nonetheless to qualify for the exception if the fund or reserve is a component of such a value or guarantee, we too might have failed to see the necessity of amending the definition of side fund. At any rate, the commenter is correct insofaras the amended definition really does say the same thing as, according to our original interpretation, the model said. The problem was that not everyone agreed with our interpretation. (5) Nowhere do the regulations explicitly indicate that universal life policies and whole life policies are not considered to be side funds. Of course they are not, but the question is whether or not certain funds or reserves that are part of or attached to these policies constitute side funds. This distinction is evident in the first sentence of

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	universal life and whole life (5) policies are not considered side funds - but (6) one must look very closely to reach that conclusion. Again, we are confused as to (1)(2) why CDI is making this change and would request that the Department go back to the same language as before which is (7) much clearer and, we believe, (4) means the same thing. Again, absent some (1), (2) clear reason why, we believe the NAIC Model provides a (8) very clear definition of a "side fund" and the exemptions to it. We therefore respectfully advocate that the Department adhere to the NAIC Model language. Please let us know if you would like further information.	the definition in all three versions. (6) This quip is not tantamount to an assertion that the regulations cannot be easily understood; one hopes and expects that insurers would always feel the need to look very closely at governing law. (7) Certainly the originally proposed language was simpler. However, because it was susceptible to another interpretation that had not occurred to the Department — and which apparently did not occur to the Mssrs. Mangan and Angelo — it was potentially ambiguous and therefore in danger of running amok of the clarity standard.